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No. 02-858

In the Supreme Court of the United States

WORLDCOM, INC., AT&T CORPORATION, AND COVAD COMMUNICATIONS COMPANY, PETITIONERS

v.

UNITED STATES TELECOM ASSOCIATION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENTS

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QUESTION PRESENTED

Whether the Federal Communications Commission's rules implementing the requirements of the Telecommunications Act of 1996 that incumbent local exchange carriers make available certain elements of their networks at the request of competing carriers are valid.

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OPINION BELOW

The opinion of the court of appeals (Pet. App. 1a-26a) is reported at 290 F.3d 415. The order of the Federal Communications Commission (FCC) in *In re Implementation of the Local Competition Provisions of the Telecommunications Act of 1996* (*UNE Remand Order*) (Pet. App. 27a-233a) is reported at 15 F.C.C.R. 3696. The order of the FCC in *In re Deployment of Wireline Services Offering Advanced Telecommunications Capability* (*Line Sharing Order*) (Pet. App. 234a-296a) is reported at 14 F.C.C.R. 20,912.

JURISDICTION

The judgment of the court of appeals was entered on May 24, 2002. Petitions for rehearing were denied on

September 4, 2002 (Pet. App. 297a-298a). The petition for a writ of certiorari was filed on December 3, 2002. The Court's jurisdiction is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. *The Telecommunications Act of 1996*

Throughout most of the United States, local telephone service has long been dominated by a single incumbent local exchange carrier, or LEC, in each service area. Such incumbents, whether regional Bell companies or independent carriers, own almost all of the loops (the wires that connect subscribers' telephones to telephone company switches) in their service areas, along with the switches themselves and the transport trunks that carry calls between switches. The incumbents' control over those facilities afforded them a *de facto* monopoly position in most local telecommunications markets. Incumbents still provide service to approximately 90% of local telephone lines. See Industry Analysis and Technology Division, FCC, *Local Telephone Competition: Status as of December 31, 2001*, at 1 (2002) (Pet. App. 314a).

As this Court has observed, incumbent carriers have enjoyed "an almost insurmountable competitive advantage" in local markets as a result of their ownership of network facilities. *Verizon Communications, Inc.* v. *FCC*, 122 S. Ct. 1646, 1662 (2002). "A newcomer could not compete with the incumbent carrier to provide local service without coming close to replicating the incumbent's entire existing network, the most costly and difficult part of which would be laying down the 'last mile' of feeder wire, the local loop, to the thousands (or millions) of terminal points in individual houses and businesses." *Ibid.* It would thus be economically

impracticable for even the largest prospective competitor to duplicate completely and immediately the functions of an incumbent's entire local network. See *Telecommunications Act of 1996*, S. Conf. Rep. No. 230, 104th Cong., 2d Sess. 148 (1996). Moreover, without rights of access to and interconnection with the incumbent's facilities, a competitor could not gradually enter the market through partial duplication of those functions; a new carrier would win few customers if those customers could call only one another but could not call customers that remained on the incumbent's separate (and completed) network. See *Verizon*, 122 S. Ct. at 1662 & n.11.

For many years, telephone regulators assumed "that [local] service could be provided at the lowest cost to the maximum number of consumers through a regulated monopoly network." *In re Implementation of the Local Competition Provisions in the Telecommunications Act of 1996* (*Local Competition Order*), 11 F.C.C.R. 15,499, 15,505 (para. 1) (1996). Until recently, therefore, "[s]tate and federal regulators devoted their efforts * * * to regulating the prices and practices of these monopolies and protecting them against competitive entry." *Ibid.*

By 1996, however, Congress had concluded that a change in regulatory assumptions and objectives would better serve the public interest. Congress designed the local competition provisions of the Telecommunications Act of 1996 (1996 Act), 47 U.S.C. 251 *et seq.*, to advance the "entirely new" objectives of, among other things, "uprooting * * * monopolies" and "jump-start[ing]" competition by "giv[ing] aspiring competitors every possible incentive to enter local retail telephone markets, short of confiscating the incumbents' property." *Verizon*, 122 S. Ct. at 1660-1661. To achieve those

objectives, Congress imposed "a host of duties" on each incumbent carrier, the "[f]oremost" of which is the "obligation under 47 U.S.C. § 251(c) * * * to share its network with competitors." *AT&T* v. *Iowa Utils. Bd.*, 525 U.S. 366, 371-372 (1999). Under Section 251(c), a competing carrier has the choice of using the incumbent's network in any of three ways: "It can purchase local telephone services at wholesale rates for resale to end users; it can lease elements of the incumbent's network [*e.g.*, loops, switching capability, etc.] 'on an unbundled basis'; and it can interconnect its own facilities with the incumbent's network." *Id.* at 371 (citing 47 U.S.C. 251(c)(4) (resale), 251(c)(3) (access to network elements), and 251(c)(2) (interconnection)).

A competing carrier's ability to lease an incumbent's network elements under Section 251(c)(3) at cost-based rates serves a crucial role in opening local markets to competition. It enables new entrants to compete broadly with incumbents, not only as to price, but also as to product, because network elements may be capable of performing functions that incumbents have not offered to their retail customers, but that competitors may incorporate into their own offerings. See *Local Competition Order*, 11 F.C.C.R. at 15,667-15,668 (paras. 332-333); *UNE Remand Order* para. 68 (Pet. App. 88a).

Section 251(d)(2) directs the FCC to determine which network elements incumbent carriers must make available to competitors. It requires the FCC, in doing so, to "consider, at a minimum, whether * * * access to such network elements as are proprietary in nature is *necessary*," and whether "the failure to provide access to such network elements [as are not proprietary] would *impair* the ability of the telecommunications carrier seeking access to provide the services that it seeks to offer." 47 U.S.C. 251(d)(2) (emphases added).

Section 252(d)(1), in turn, directs that the rates at which incumbents lease their network elements to competitors shall be just, reasonable, and nondiscriminatory, and shall be "based on the cost * * * of providing the * * * network element." 47 U.S.C. 252(d)(1).

2. ***The Local Competition Order***

In August 1996, the FCC issued its initial order addressing the most basic issues arising under the local competition provisions of the 1996 Act. In the order, the FCC determined that it had the authority to adopt a broad range of implementing rules that state public utility commissions would apply in arbitrating and approving interconnection agreements between incumbents and new entrants under Section 252. See *Local Competition Order*, 11 F.C.C.R. at 15,513 (para. 24). Those rules, among other things, addressed the rates, terms, and conditions under which incumbents must share their networks with competitors.

With respect to pricing of network elements, the FCC prescribed a methodology, Total Element Long-Run Incremental Cost (TELRIC), which reflects the "forward-looking" cost of providing a network element (*i.e.*, the amount that it would cost, in today's market, to replace the functions of the element), rather than its "historical" cost on an incumbent's accounting books. See *Local Competition Order*, 11 F.C.C.R. at 15,844-15,586 (paras. 674-703). The FCC reasoned that "[i]n dynamic competitive markets, firms take action based not on embedded costs, but on the relationship between market-determined prices and forward-looking economic costs." *Id.* at 15,813 (para. 620). Accordingly, the FCC determined that such a forward-looking methodology "best furthers the goals of the 1996 Act." *Ibid.*

With respect to which network elements incumbents must make available to competitors, the FCC construed the "necessary" and "impair" standards set forth in Section 251(d)(2). The FCC found that the failure of an incumbent to provide access to non-proprietary elements would "impair" a competitor's ability to provide service if, without such access, the quality of the competitor's service would decline or its cost would rise "compared with providing that service over other unbundled elements in the incumbent LEC's network." *Local Competition Order*, 11 F.C.C.R. at 15,643 (para. 285). The FCC found that access to proprietary elements was "necessary" if, without such access, a competitor's "ability to compete would be significantly impaired or thwarted." *Id.* at 15,641-15,642 (para. 282). The FCC indicated that neither inquiry would include consideration of whether a competitor could obtain the element "from a source other than an incumbent." *Id.* at 15,642 (para. 283) ("necessary" standard); *id.* at 15,643-15,644 (paras. 286-287) ("impair" standard). In other words, an element would be "necessary" or its absence would cause "impair[ment]" if no other element within the incumbent's network was a suitable substitute, even if the competing carrier could provide the same function itself or could obtain it from another source. Applying its understanding of Section 251(d)(2), the FCC adopted a list of network elements that incumbents must provide to competitors. See *Local Competition Order*, 11 F.C.C.R. at 15,514-15,515 (para. 27); *id.* at 16,209-16,213 (Rule 51.319).

3. *Judicial Review Of The Local Competition Order*

a. The United States Court of Appeals for the Eighth Circuit invalidated the FCC's pricing rules on the ground that the 1996 Act gives state public utility

commissions, not the FCC, the authority to interpret the pricing provisions of Sections 251 and 252. *Iowa Utils. Bd.* v. *FCC*, 120 F.3d 753, 794-800 (1997). The court also invalidated on the merits certain of the FCC's rules regarding network element performance features and combinations. *Id.* at 812-813, 820. The court upheld the FCC's understanding of the "necessary" and "impair" requirements of Section 251(d)(2), as well as the FCC's list of network elements that incumbents must make available to competitors. *Id.* at 810-812.

b. This Court reversed the court of appeals' jurisdictional ruling, holding that the FCC has statutory authority to establish pricing standards under Sections 251 and 252. *AT&T*, 525 U.S. at 377-386. The Court remanded the pricing rules for consideration on the merits. The Court upheld several of the FCC's other rules, including those defining a network element, permitting a competing carrier to provide service solely using elements leased from an incumbent's network, and forbidding an incumbent, against a competitor's wishes, to separate already combined elements before leasing them. *Id.* at 386-387, 392-395.

The Court held, however, that the FCC had not adequately considered the "necessary" and "impair" standards in Section 251(d)(2). *AT&T*, 525 U.S. at 387-392. First, the Court noted that the FCC had declined to consider whether a competing carrier, instead of obtaining a network element from the incumbent, could provide the element itself or obtain it from another source. The Court concluded that the FCC "cannot, consistent with the statute, blind itself to the availability of elements outside the incumbent's network." *Id.* at 389. Second, the Court rejected the FCC's suggestion that the "necessary" and "impair" standards would be satis-

fied if, as a result of not being able to obtain an element in the incumbent's network, a competing carrier would incur any increase in its costs or any decrease in the quality of its service. The Court acknowledged that such factors could be determinative if they denied the carrier a realistic opportunity to provide service on a competitive basis, but found that the FCC had not established that such a result would occur "ipso facto" due to any cost or quality differences. *Id.* at 389-390. The Court directed the FCC, on remand, to implement Section 251(d)(2) in a manner that provides "*some* limiting standard, rationally related to the goals of the Act." *Id.* at 388.

c. On remand, the Eighth Circuit held that, although the 1996 Act permitted the FCC to use a forward-looking methodology for pricing network elements, the particular methodology used by the FCC was inconsistent with the Act. *Iowa Utils. Bd.* v. *FCC*, 219 F.3d 744 (2000).

d. This Court reinstated the FCC's network element pricing rules. *Verizon*, 122 S. Ct. at 1665-1681. The Court concluded that the FCC's forward-looking TELRIC methodology is consistent with the text and purposes of the 1996 Act. In particular, the Court held that the FCC could reasonably determine that pricing network elements based on forward-looking cost would provide appropriate incentives for competitors to enter local markets and for incumbents to maintain and upgrade their networks. The Court noted that new entrants had engaged in "substantial competitive capital spending" during the four years since the implementation of the 1996 Act, and that incumbents "have invested 'over $100 billion' during the same period." *Id.* at 1676 & n.33 (quoting dissenting opinion of Justice Breyer). The Court viewed that evidence as confirming

"the commonsense conclusion that so long as TELRIC brings about some competition, the incumbents will continue to have incentives to invest and to improve their services to hold on to their existing customer base." *Id.* at 1676.

4. *The UNE Remand Order And The Line Sharing Order*

a. On remand from this Court's decision in *AT&T*, the FCC revised the standards for determining which network elements an incumbent must make available to competitors. See *UNE Remand Order*, *supra* (Pet. App. 27a-233a). The FCC, in accordance with this Court's directive, reconsidered the statutory standards of "impair[ment]" and "necess[ity]." In addition, the FCC explained that, because Section 251(d)(2) requires the FCC to consider impairment and necessity "at a minimum" in deciding which elements must be made available, the FCC may consider other factors as well. Accordingly, the FCC stated that it would also consider whether the availability of an element would advance the statutory goals of rapid introduction of competition; facilities-based competition, investment, and innovation; reduced regulation; market certainty; and administrative practicality. 47 C.F.R. 51.317(b)(3).

With respect to the impairment standard applicable to non-proprietary network elements, the FCC determined that a competing carrier would be impaired by its inability to obtain an element from an incumbent "if, taking into consideration the availability of alternative elements outside the incumbent LEC's network, * * * lack of access materially diminishes a requesting carrier's ability to provide the services it seeks to offer." 47 C.F.R. 51.317(b)(1) (Pet. App. 218a-219a). The FCC added that whether a competitor's ability to provide

services would be "materially diminish[ed]" is analyzed by comparing the incumbent's network elements with elements from other sources in terms of relative cost, quality, ubiquity, timeliness of deployment, and impact on network operations. 47 C.F.R. 51.317(b)(2) (Pet. App. 219a).

With respect to the cost component of that inquiry, the FCC identified three kinds of cost disparities that could bear on whether lack of access to an incumbent's network element would result in the requisite degree of impairment: (1) cost disparities attributable to economies of scale or scope that may cause new entrants to incur higher unit costs than incumbents, particularly in the early stages of entry, *UNE Remand Order* para. 76 (Pet. App. 92a); (2) cost disparities attributable to the "sunk" nature of investment in some facilities that cannot be redeployed if the competitor stops providing service, *id.* para. 77 (Pet. App. 93a-94a); and (3) cost disparities attributable to other "additional costs" that are incurred only by new entrants and not by incumbents, *id.* para. 78 (Pet. App. 94a).

The FCC observed that the impairment inquiry cannot practicably be conducted for "every potential carrier seeking access to each network element on a case-by-case basis." *UNE Remand Order* para. 54 & n.98 (Pet. App. 76a); see *id.* para. 65 (Pet. App. 85a). The FCC did, however, tailor its requirements for which network elements must be made available to account for geographic and customer-segment differences where the record warranted. See *id.* paras. 276-278 (Pet. App. 171a-174a) (establishing geographic and customer-segment limitations on the availability of the switching element).

The FCC, after applying its revised standard, specified a revised list of network elements that is narrower

in some respects and broader in other respects than its original list. 47 C.F.R. 51.319 (Pet. App. 220a-233a).

b. In its separate *Line Sharing Order*, the FCC applied the impairment standard from the *UNE Remand Order* "to require [incumbents] to provide unbundled access to a new network element, the high frequency portion of the local loop." *Line Sharing Order* para. 4 (Pet. App. 238a). A competing carrier could thus use that element to provide digital subscriber line (DSL) service over the high-frequency portion of the loop while the incumbent carrier continued to provide voice service over the low-frequency portion of the same loop. See *id.* paras. 29-61 (Pet. App. 261a-288a).

The FCC rejected the argument that incumbent carriers should not be required to provide access to the high-frequency portion of the local loop because cable operators have not been required to provide access to their systems to provide similar service. The FCC noted that the 1996 Act "explicitly makes distinctions based on a common carrier's prior monopoly status." *Line Sharing Order* para. 59 (Pet. App. 286a). In particular, the FCC noted that Section 251(c)(3) requires incumbent carriers to provide network elements to competitors, but does not impose similar obligations on cable operators. *Line Sharing Order* para. 59 (Pet. App. 286a- 287a).

5. *The Court Of Appeals' Decision In This Case*

The United States Court of Appeals for the District of Columbia Circuit granted petitions for judicial review of the *UNE Remand Order* and the *Line Sharing Order*. Pet. App. 1a-26a.

a. The court found fault with two facets of the *UNE Remand Order*: the FCC's adoption (with respect to most, but not all, network elements) of uniform national

unbundling rules that apply across geographic markets and customer classes, see Pet. App. 10a-18a, and the FCC's analysis of cost disparities as they relate to whether a competing carrier's ability to provide service would be materially impaired without access to a particular network element, see *id.* at 18a-22a.

First, with respect to uniform nationwide unbundling obligations, the court of appeals suggested that this Court's decision in *AT&T* "requir[ed] a more nuanced concept of impairment" than the FCC had adopted. Pet. App. 18a. The court viewed the *UNE Remand Order* as requiring incumbents to make network elements available to competitors "in many markets where there is no reasonable basis for thinking that competition is suffering from any impairment of the sort that might have [been] the object of Congress's concern." *Id.* at 10a. In particular, the court criticized the FCC for not taking into account "market-specific variations in competitive impairment" that may result from retail rate structures prescribed by state commissions, "typically in the name of universal service," under which incumbents must charge some customers (*e.g.*, those in rural areas) "below cost" rates but may charge other customers (*e.g.*, those in urban and suburban areas) "above cost" rates. *Id.* at 10a-12a. The court rejected the FCC's conclusion that uniform nationwide rules would advance congressional goals by, among other things, encouraging rapid competitive entry into local markets as well as investment in facilities by both new entrants and incumbents. *Id.* at 13a-17a.

Second, the court of appeals criticized the FCC's ostensibly "open-ended notion of what kinds of cost disparity are relevant" to whether competitors would be materially impaired without access to incumbents' network elements. Pet. App. 19a. The court stated

that the FCC had not adequately justified "[a] cost disparity approach that links 'impairment' to universal characteristics" faced by start-up companies in many industries, "rather than ones linked (in some degree) to natural monopoly." *Id.* at 20a-21a.

b. The court of appeals held that the *Line Sharing Order* suffered from the same deficiencies as the *UNE Remand Order*. Pet. App. 25a. In addition, the court faulted the FCC for "fail[ing] to consider the relevance of competition in broadband services coming from cable (and to a lesser extent satellite)" in concluding that competing carriers would be materially impaired without access to the high-frequency portion of the loop. *Id.* at 23a.

c. The court of appeals remanded both the *UNE Remand Order* and the *Line Sharing Order* to the FCC "for further consideration in accordance with the principles outlined" in the court's opinion. Pet. App. 26a.*

6. *The Triennial Review*

In the *UNE Remand Order*, the FCC undertook to revisit its unbundling rules in three years. *UNE Remand Order* para. 15 (Pet. App. 37a). Accordingly, in December 2001, the FCC initiated that "Triennial Review" proceeding "to ensure that our regulatory framework remains current and faithful to the pro-competitive, market-opening provisions of the 1996 Act in light of our experience over the last two years, advances in technology, and other developments in the markets for telecommunications services." *In re Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers* (*Triennial Review*

* The court of appeals subsequently denied petitions for rehearing and rehearing en banc filed by the FCC and the United States, as well as by petitioners here.

NPRM), 16 F.C.C.R. 22,781, 22,782-22,783 (para. 1) (2001). Among other things, the FCC sought comment on whether to adopt a more "granular" unbundling analysis that, for example, distinguishes among categories of customers, services, and geographic markets. *Id.* at 22,797-22,802 (paras. 34-46). After the decision in this case, the FCC incorporated into the Triennial Review the inquiries that the court of appeals directed it to engage in on remand.

DISCUSSION

The court of appeals' decision is erroneous for many of the reasons set forth in the petition. The decision does not accord appropriate deference to the FCC's reasonable implementation of a complex statute—one that this Court has recognized to be "in many important respects a model of ambiguity" that "Congress [was] well aware" would "be resolved by the implementing agency." *AT&T*, 525 U.S. at 397; accord *Verizon*, 122 S. Ct. at 1687. The decision is thus in significant tension with this Court's reasoning in *Verizon* and *AT&T*. The United States and the FCC nonetheless did not petition for certiorari, principally because the FCC is currently engaged in a comprehensive review of the very policy choices reflected in the orders at issue. For that reason, and to conserve both judicial and agency resources, the government has concluded that the court of appeals' decision does not, on balance, warrant review at this time.

1. Last Term in *Verizon*, this Court reiterated the circumscribed role of the judiciary under *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843-845 (1984), in reviewing challenges to an expert agency's implementation of a complex, broadly drafted statute. The Court acknowl-

edged that "[w]hether the FCC picked the best way to set [network element] rates is the stuff of debate for economists and regulators versed in the technology of telecommunications and microeconomic pricing theory." *Verizon*, 122 S. Ct. at 1687. The Court emphasized, however, that "[t]he job of judges is to ask whether the Commission made choices reasonably within the pale of statutory possibility in deciding what and how items must be leased and the way to set rates for leasing them." *Ibid.* The court of appeals did not confine itself to that inquiry in this case.

As the court of appeals recognized, the 1996 Act provides the FCC with "no detail" about how to carry out the "extraordinar[ily] complex[]" task of determining which network elements incumbent carriers must make available to competitors. Pet. App. 10a. The Act directs the FCC simply to "consider, at a minimum, whether * * * the failure to provide access to [non-proprietary] network elements would impair the ability of the telecommunications carrier seeking access to provide the services that it seeks to offer." 47 U.S.C. 251(d)(2)(B); see 47 U.S.C. 251(d)(2)(A) (proprietary elements). This Court construed that text in *AT&T* as "requiring the FCC to apply *some* limiting standard, rationally related to the goals of the Act." 525 U.S. at 388; see *id.* at 390 (observing that Congress did not intend "to give blanket access to incumbents' networks" on an "unrestricted" basis, because then Congress "would simply have said * * * that whatever requested element can be provided must be provided").

On remand, the FCC revised its unbundling rules in accordance with this Court's holding with respect to the minimum requirements of Section 251(d)(2). It required incumbents to make available only those non-proprietary elements without which a competing car-

rier's ability to provide service would be "materially diminishe[d]" in terms of cost, quality, or other such factors, "taking into consideration the availability of alternative elements outside the incumbent LEC network." 47 C.F.R. 51.317(b)(1) and (2). That revised standard follows the direction from this Court to provide a "limiting standard, rationally related to the goals of the Act." Consistent with the Court's directive, the revised standard explicitly considers the "availability of elements outside the incumbent's network." Moreover, heeding the Court's caution that *de minimis* cost disparities alone do not warrant unbundling, the revised standard requires an examination of whether increases in cost (or other factors) cause a "material" diminishment of a competing carrier's ability to provide service. The FCC's revised approach, implementing a statute that provides "no detail" about how the agency is to determine which network elements are to be made available, is "reasonably within the pale of statutory possibility." *Verizon*, 122 S. Ct. at 1687.

2. Despite the deficiencies in the court of appeals' decision, the United States and the FCC decided not to seek this Court's review. Instead, the FCC elected to proceed with its ongoing Triennial Review (see pp. 13-14, *supra*) to consider what changes, if any, should be made in its unbundling rules in light of experience, advances in technology, and developments in the marketplace. In that proceeding, the FCC has sought comment on a variety of issues, including those raised by the court of appeals in this case, and is currently evaluating an extensive administrative record.

The FCC does not agree with the court of appeals as to what analysis is required by the 1996 Act in order to ascertain which elements of incumbents' networks should be made available to competing carriers. Even

before the court's decision, however, the FCC had determined, as a matter of discretion, to engage in much of the same analysis that the court subsequently directed. For example, the FCC sought comment on whether to adopt a more "granular" approach to unbundling that considers, among other things, differences among geographic regions, services, and customers. *Triennial Review NPRM*, 16 F.C.C.R. at 22,797-22,802 (paras. 34-46). The FCC also sought comment on crafting unbundling rules that could more effectively encourage facilities investment and broadband deployment. *Id.* at 22,791-22,796 (paras. 22-30).

The FCC has not completed the Triennial Review, although it expects to do so shortly. At the conclusion of that proceeding, the FCC will articulate its current understandings of the legal and policy questions bearing on network element unbundling, and may revise the rules at issue here in light of those understandings. In these circumstances, the government has concluded that review of the court of appeals' decision is not necessary at this time, and thus would not be an efficient use of judicial or agency resources.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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